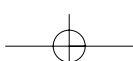
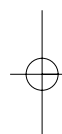
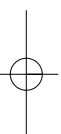
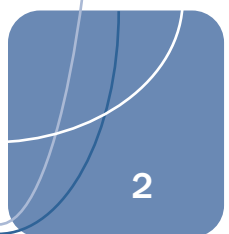
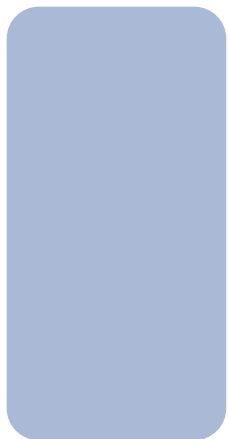
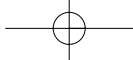


Foreword

Mr Moore has asked that special thanks be extended to Ms Julie Novak for her valuable assistance and advice while Senior Policy Analyst at Commerce Queensland until February (she has recently moved to the Productivity Commission); to Mr Michael Cunningham, formerly of the Queensland Treasury, for the Appendix on “Achieving Sustained Economic Growth”; and to Dr John Nethercote for the Appendix on “Enhancing Public Accountability of Queensland Government”. Mr Moore also wishes to acknowledge the many experts in education, health, and public affairs who provided advice and commentary on drafts of this report. However, he accepts full responsibility for the views expressed herein. The report was commissioned by Commerce Queensland as a basis for informed debate and Commerce Queensland does not necessarily support all of these views.

Foreword

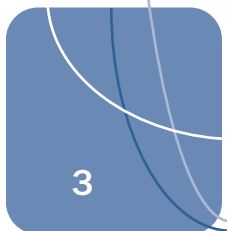
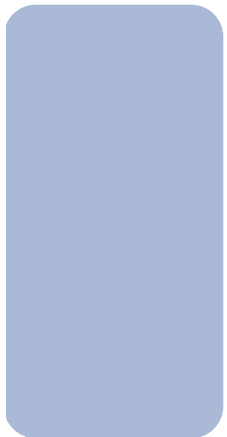


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About the Author

About the Author

Mr Des Moore is a graduate in law from Melbourne University and in economics from the London School of Economics. During his 28 years in the Commonwealth Treasury, he was, at one time or another, head of most of the main policy areas, including the divisions responsible for producing the Commonwealth budget and for federal-state financial relations. His last five years in the Treasury were as one of three Deputy Secretaries.

In February 1987, Mr Moore resigned from Treasury at age 55 to join the Melbourne based think-tank, the Institute of Public Affairs, as the Senior Fellow of the Economic Policy unit. One of his many publications at the IPA was “Commonwealth Budget: Cut Spending by \$15-16 Billion”, February 1995.

In February 1996 Mr Moore decided to establish his own think-tank, the Institute for Private Enterprise, to promote the role for genuine private enterprise in Australia. As director he has published on a wide range of issues regarding the respective roles of government and the private sector in Australia.

In 2001 he was appointed to the board of the Australian Strategic Policy Institute (ASPI) that was established by the Government as an independent think-tank on defence and strategic issues. That appointment was renewed in 2005. In 2003 he was appointed to the Board of the Public Sector and Commonwealth Superannuation Schemes.

In May 2005 The Australian Chamber of Commerce and Industry published a report it had commissioned Mr Moore to undertake on “Commonwealth Spending (and Taxes) Can be Cut – and Should Be”.

Executive Summary

Introduction

- This report focuses mainly on the period since the present government assumed office in June 1998. It argues there would be significant benefits from a major shift in policy designed to increase the role of the private sector in the provision of “government” services. Yet little progress has been made even in implementing the purchaser/provider recommendations of the 1996 Audit Commission report. And policy changes should go beyond those;
- Queensland has been growing faster than other states but remains a clear fourth in per capita incomes, 19 per cent lower than in Western Australia and 12 per cent lower than in NSW and Victoria. Convergence with higher per capita incomes in those states has been slower than might have been expected given Queensland’s many attractions;
- A larger contribution by the private sector to total Queensland expenditure should help. Although that share of the total has increased from 76 to over 79 per cent in recent years, other states have moved in the same direction. Queensland’s private sector still makes a smaller relative contribution than in three states;
- It is in the interests of the Queensland government and the Queensland community for the private sector to have a larger relative role. The resultant increase in competition and choice would improve the quality and efficiency of existing government services. It would also help the state’s budget.

Developments in the Role of Government

- A larger private sector policy would be consistent with the declining size of government since the early 1990s in most OECD countries including Australia. Moreover, Australians have for many years been more accepting than Europeans of greater private sector involvement in education and health and other services traditionally provided by government. There is now no clear dividing line between what role the two sectors “should” perform;
- Various influences behind the relative decline in government include the increased capacity of individuals to manage their own affairs, greater recognition of the extent of the adverse effects of taxation, increased protection provided to individuals from a more competitive economy, the growing importance of private sector driven technological change, greater scepticism about the virtues of government financed services/ projects, and increased recognition of the private sector’s potential as an efficient supplier of most “government” services;
- In Australia almost bipartisan political agreement exists against increasing taxation to expand the size of government and COAG has agreed that the public sector needs to effect more competition-driven and regulatory-reducing reforms. Options for such reforms amongst state governments include privatisation with competition regulation, public/private partnerships and the contracting out and/or franchising of service provision. States could also provide overt support, both general and financial, to encourage greater *direct* private sector involvement in the provision of “government” services;
- Entrenched interests and traditionalists oppose such reforms partly because of distrust of private enterprises and their profit objectives and partly because they would reduce their

political power. But in Australia's current competitive operating environment such opposition appears to have little substantive economic or social basis;

- Moreover, communities in all states are increasingly using private sector services competing with "government" services in, for example, education and hospitals. In Queensland over 30 per cent of students already attend non-government schools and 47 per cent of patients are treated in private hospitals. Some overseas countries allow public education money to be used at any school meeting minimum requirements;
- There is also widespread acceptance of the benefits from governments providing financial assistance that allows private sector organisations to expand their operations in these fields. For non-government schools federal and state grants now provide nearly 60 per cent of their income and for private hospitals 35 per cent of their income is derived from government.

Existing Roles of Government and Private Sector in Queensland

- While Queensland and other states have been slow to recognise the improved efficiency from services privatised in Victoria and from that state's increased resort to public/private partnerships, there now appears to be an increasing willingness by governments to use private sector enterprises as providers of "government" services. The Queensland government has recently indicated it is favourably disposed to privatising a major part of the electricity industry and that it will evaluate \$5.6 billion worth of potential public-private projects;
- Analysis of the expenditure components of Queensland gross state product indicates that since 1997-98 business investment has been the driving force behind the state's growth and now constitutes about 75 per cent of total investment (excluding dwellings) in the state. The much faster growth in business investment than total public sector investment (3.5 times faster) raises questions as to the latter's adequacy;
- Over the same period private sector employment has also grown considerably faster than public sector employment (3.1 per cent pa compared to 1.8 per cent pa). However, the proportion of Queensland's employment in the public sector is higher than the states' average (equivalent to about 8,000 employees) and the public *service* component has increased particularly strongly (3.4 per cent pa). Average earnings of public sector employees are about 3 per cent lower than the average for the states;
- Nearly 60 per cent of public sector employees are members of trade unions compared with 19 per cent for private employees;
- Total expenditure by Queensland's *general government* sector (ie excluding public corporations and local government) is lower than the states' average (about 5 per cent or \$900 million on a comparison of like with like), although some items of spending are higher;
- This continues Queensland's long standing policy of being a low tax state. The Grants Commission's assessment for 2004-05 shows average tax rates about 14 per cent or \$1,078 million below the states' average. Following the replacement in 2000-01 of general revenue grants with stronger-growing GST revenue, Queensland along with other states has been able to reduce the burden of state taxes but that has, in turn, reduced the proportion of self-raised revenue to just over 50 per cent.

The Performance of the Queensland Economy

- Since 1997-98 Queensland's much faster growth in population (2.2 per cent pa compared to 1.3 per cent pa) has been the most important immediate cause of its faster economic growth (5 per cent pa compared to 3.5 per cent pa for Australia). However, this favourable growth "gap" of 1.5 percentage points narrows to only 0.7 points in per capita terms;
- The relative slowness of per capita incomes to converge does *not* reflect higher proportions of retirees or a lower rate of participation in the workforce;
- It may, rather, reflect the state's industry structure, which appears to be oriented more towards industries in which earnings of employees tend to be lower than average. For example, Queensland's mining industry contributes a relatively modest proportion of production (5.4 per cent) particularly when compared with Western Australia (18 per cent). However, the downwards influences are in industries other than agriculture, which accounts for only about 4 per cent of total production;
- A policy of reducing the regulation of investment in higher income industries might help diminish the per capita income differences.

Queensland's Budgetary Outlook

- Various recent decisions to increase budgetary expenditure, particularly in health, have almost certainly eliminated the operating surpluses of \$140-250 million estimated for the three years 2006-07 to 2008-09 and possibly even the estimate of \$718 million for the current year. While the state's strong balance sheet would allow considerable borrowings to finance capital expenditure in the general government sector without having adverse effects on the AAA credit rating, it would be fiscally (and morally) responsible to return the budget to operating surpluses of around 1 per cent of GSP;
- However, the revenue projections in the state budget suggest that the state faces a major deterioration in its capacity to finance expenditure growth, let alone budget for operating surpluses. Thus projections out to 2008-09 suggest an increase in nominal terms of total revenue of only 4 per cent pa, much slower than the 7 per cent pa increase in GSP and also much slower than the 7 per cent pa growth in revenue from 1997-98 to 2005-06;
- The main reason for this development is the much slower projected growth in revenue from the GST. Thus, whereas Queensland's GST receipts increased at 10.3 per cent pa from 2000-01 to 2005-06, they are now projected to increase at only about 4 per cent pa, due to an expected slower growth in national consumption expenditure and an expected reduction in Queensland's share of GST revenues. This means that in 2008-09 Queensland will have about \$2.7 billion less in revenue than if the previous GST growth rate had continued. In short, the GST "bonanza" appears to be over;
- Even if the GST revenue projections by the federal treasury turn out to be "conservative", Queensland faces a period in which it will have much diminished capacity to finance expenditure growth. This reinforces the desirability of increasing the role of the private sector in the provision of "government" services.

Executive Summary

How the Private Sector's Role Can Be Increased

- A competitive framework for the supply of “government” services provides the greater range of choices increasingly preferred in educated societies. This is reflected in their growing utilisation of privately supplied services even though they are subject to fees or charges while government services are not. The greater accountability and testing of suppliers in a market-oriented framework also helps explain this increased demand;
- The prospect for accountability testing of government provision of services might be enhanced, however, if Queensland re-established its upper house as a house of review;
- A more competitive framework would not mean a two-tier system in which lower standards of services are provided for those with low incomes or with disabilities of some form. Where appropriate, subsidies can be provided (and are already) to allow the setting of a certain standard and the private sector can compete for supply on that basis;
- A move towards a more competitive framework can take two main forms, viz. the purchaser/provider model recommended by the 1996 Audit Commission, including contracting out, and policies that specifically encourage the establishment/expansion of competing private sector services, including the replacement by them of government services;
- With the extensive assistance now provided by both federal and state governments to non-government schools, a liberalisation of state policies towards non-government schools has the potential to establish seriously competitive conditions as well as helping the budget. Liberalisations should include effecting a faster increase in state grants; making low interest loans available for capital expenditure; giving ready accreditation to new applicants; changing regulations to require only minimal curricula and to allow new schools to compete without taking account of other schools in the area; allowing “for profit” schools where profits are expendable only on the school; giving non-government school groups preference in areas where new schools are needed; rationalising the large number of under-utilised/under-sized government schools, with non-government schools invited to be part of the rationalisation process; and announcing no further reductions to existing average student/teacher ratios in government schools;
- Analysis by Dr Mark Harrison (“Education Matters”) indicates that a school education system operating under competitive conditions is likely to have greater involvement of parents and a strengthened role for families;
- The great increase in patient numbers and treatments in Queensland private hospitals since 1997-98 reflects the increased government assistance provided mainly through the federal health insurance rebate, their capacity to provide almost the full complex of treatments, their recognition by the Australian Council on Health Care Standards and by the general public as hospitals that generally perform better than public hospitals, and their lower average costs structures;
- A liberalisation of state policies towards private hospitals would also help both their expansion on a competitive basis and the state budget in circumstances where further significant increases in demand for additional hospital treatment are likely. Government policy changes should include an indication of general support for a further large expansion in private hospitals and more positive action to fulfill the statement in 2004 of a preparedness to establish a more cooperative relationship with such hospitals; an indication that a further reduction in public hospitals is anticipated (there was a reduction of 12 over the six years to 2003-04 and an increase of 21 in private hospitals); the establishment of a

normal waiting time of 12 months for private (insured) patients wanting treatment in public hospitals even though they could readily be treated in private hospitals; and the offer of low interest loans to help fund the expansion of private hospitals or the establishment of new ones;

- As to public sector investment, notwithstanding the announced \$55 billion planned “additional” infrastructure investment over 20 years, the budget projections provide for a fall in public sector investment over the next three years and it is difficult to identify what is “additional” in aggregate terms. With the rapid growth in business investment and associated demands for increased infrastructure, this indicates the need for clarification of State policies on the role for investment by the private sector in areas where the Queensland government has traditionally provided or is currently providing most of the services;
- First, given the government’s actual or foreshadowed involvement in specified individual projects with the private sector, and its announced evaluation of \$5.6 billion of potential public-private partnerships, the government should make a general statement indicating such partnerships and/or contracting out will be used wherever practicable and efficient;
- Second, given the government’s indication that it is favourably disposed to the privatisation of a major part of the electricity industry, it should make a similar general policy statement indicating that it favours selling most of the \$22 billion of public corporation assets. In line with this, the Boston Consulting report on 24 April recommended sale of all electricity assets. However, while the Premier has agreed to the sale of electricity retailers, he has ruled out the sale of generation and transmission assets. The latter decision can be challenged, as a general policy of asset sales is well justified by the analysis by the Productivity Commission showing an average return on assets of only around 5 per cent (compared with the 9.5 per cent average cost of capital for companies). Allowing for the loss of dividends and tax equivalent payments, their sale should produce a net saving to the budget.

A Package of Lower Taxation and Regulation

- Notwithstanding the deterioration in the budgetary outlook, there is potential for a reduction in state taxes of between \$1,000 and \$1,500 million compared with estimated state tax revenue of nearly \$7 billion in 2005-06. This would need to be spread over a period by, first, giving priority to a program of lower taxes over various items of what might be classified as “more marginal” expenditures and, second, by securing savings in government spending through an enhanced program of encouraging the private sector to assume responsibility for a significantly increased proportion of “government” services;
- Reductions in “more marginal” expenditure in favour of lower taxes might include reductions in petroleum subsidies and further reductions in concessional electricity tariffs; in well-above-average expenditure on “general public services”; in savings by the Service Delivery Commission (Premier’s target of \$100 million) from minimising duplication and inefficiencies such as those resulting from the government printer, centralised public works maintenance, and the use of unnecessary incentives designed to attract business investment to Queensland; in savings from sharply reducing the growth over five years in the number and average earnings of public service employees so as to make expenditures on employment consistent with the lower expected growth in revenue, and by amalgamating departments with similar functions;

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- The sale of the major assets of public corporations would allow a reduction in gross state debt, producing net savings in recurrent budget expenditure (after allowing for the loss of dividends and tax equivalent payments);
- An enhanced program/policy for the private sector to provide an increased proportion of “government” services would also produce savings in addition to what might otherwise have occurred without such a program. If, for example, the proportion of students attending non-government schools could be lifted to 36 per cent by 2010-11, the net saving to the government from the operations of such schools could be about \$1.9 billion in that year compared with \$1.7 billion if the proportion increased to 32.7 per cent (and just over \$1 billion in 2005 when it was 30.3 per cent). In the case of private hospitals, an enhanced program may be needed simply to maintain the high rate of increase in treatments at such hospitals, which are projected to save over \$1.7 billion in 2009-10 compared with \$1.4 billion in 2003-04. There would also be sale proceeds from closures of schools and hospitals no longer required in the public sector;
- The two approaches outlined would need to be complemented by a major program of reduced regulation of businesses. Many studies (including by the OECD) point to the adverse effects on business activity and, hence, on employment of excessive, poorly-designed and/or badly administered regulation. The large increase in legislation so far this decade (the highest amongst the states) signals the general problem and the government’s “Review of Hot Spots for Regulatory Reform” in the Department of State Development, Trade and Innovation has not so far produced a comprehensive reform program;
- As with taxation reductions, it is a matter of determining priorities at the margin - is it better to get the benefits to the community as a whole from having lower taxation and regulation rather than having questionable benefits for (usually) only a few from expenditure or regulation that is marginal and debatable?

Introduction

The June 1996 report of the Queensland Commission of Audit, headed by Dr Vince Fitzgerald of Allen Consulting,¹ recommended that the then government “strongly separate its role as a demanding purchaser of services, on behalf of the community, from the role of service provider; that it fund providers only against service outputs or results; and that it ensure that providers face competitive pressures to improve performance continuously”. The report also observed that “the Government’s involvement in business is plainly too extensive and in many cases performance is mediocre relative to benchmarks. Some of these assets should be sold and others exposed to more competition”. Although some movement has since been made towards implementing these recommendations, it would not be surprising if, nearly 10 years on, the Commission members were to express considerable disappointment at the pace of progress.

As Queensland has experienced faster population and economic growth than any other state since the 1996 audit, it might be thought the need for reform at the state level is limited. But average per head incomes are still about 10 per cent below the national average and the “gap” has been closed only slightly: Queenslanders are now slightly ahead of South Australians but well behind NSW, Victoria and WA. A faster convergence in per head incomes might have been expected given Queensland’s many natural attractions, its extensive resources of minerals and land, and a faster growth in its working age population than in other states.

While the higher per head costs of government in smaller states have the potential to detract from income levels, this should not have had significant adverse implications on Queensland as the system of distributing GST revenues between the states has taken into account the possible adverse cost and revenue effects on the main component of government.² In short, with its resources and a population now only 20 per cent less than Victoria’s, Queensland should not now have an average per capita income almost 12 per cent lower.

The reasons for the slowness in convergence of per capita incomes are not readily apparent and may to some extent simply reflect a “natural” tendency for the state to attract industries that generate lower average incomes. But arguably the Queensland Government could have done more to identify and encourage the sector that is the driving force in growth and employment, viz. the private sector. Of relevance are statements by the recently appointed Treasurer of NSW, Mr Michael Costa, indicating recognition of the importance of creating a more “business-friendly” framework in a state that has been experiencing relatively poor economic performance.³

True, the relative contribution of Queensland’s private sector to total state expenditure has increased from just over 76 per cent in the early 1990s to the point where it now accounts for over 79 per cent. But, while it is difficult to judge the extent to which that contribution may have influenced the faster than average growth in the state’s average per capita income, it could only have been helpful if the sector in which productivity tends to be higher – the private sector – had further increased its contribution. Queensland’s private sector is still relatively smaller than in

¹ The other members of the Commission were Professor Jeff Carmichael, Bond University; Mr Darryl McDonough, Partner, Clayton Utz; and Mr Barry Thornton, Chairman GWA International Limited. Dr Peter Crossman, Queensland Treasury was head of the Secretariat.

² The Commonwealth Grants Commission assesses Queensland as requiring a higher than average per capita share of GST revenues due to it having a relatively lower than average capacity to raise revenue and a relatively higher than average cost of delivering services, including the additional costs from the state’s greater dispersion of population. However, the extent of the higher share is small. In 2005-06 the additional revenue (compared with an equal per capita distribution) is estimated to be \$369.3 million, or about 1.4 per cent of total revenue.

³ “Our challenge is to create a climate that is conducive to investment rather than engaging in a ‘picking winners Dutch auction’ on particular events or investments”, Michael Costa, Australian Financial Review, 17 February 2006. Also of relevance is the statement by the former Liberal Prime Minister of Canada, Paul Martin, that “Governments can no longer pick winners, but losers can still pick governments” reported in an article by the former Prime Minister of New Zealand, Mike Moore, Australian Financial Review, 21 February, 2006.

Introduction

three of the states (including NSW) and the importance of its contribution to investment and employment seems insufficiently acknowledged as the driving force in the Queensland economy.

Government in Queensland seems rather too inward looking, too protective of what it perceives to be its proper role (and too concerned with implementing it) rather than what might be the best institutional framework and most productive policy for the economy and society as a whole.⁴ It also seems too focussed on interventionist action based on the identification by government rather than entrepreneurs of which industries are most likely to produce faster growth rather than the adoption of more generalised policies that would create a favourable entrepreneurial environment.⁵ If low taxation, minimal regulation and adequate infrastructure provide an economic environment that is favourable to private investment, such investment will flow without specific government assistance or the need for full page media advertisements (for further analysis, see Appendix on “Achieving Sustained Economic Growth”).

This report thus proposes that the principal agenda for the state’s public policy should now become how to develop a relatively larger role for the private sector. This can be pursued in various ways, both within and outside government.

If the Queensland Government were to become really smart, it could start by offering the private sector a greater role in the delivery of major services and by adopting policies that are more overtly conducive to private investment in infrastructure. Once established, the active pursuit of such an approach would have favourable feedback effects, leading to the state being identified as the most attractive to private investors, with resultant benefits for growth and employment. The opportunity is there for the taking: policies ranging from the delivery of services to the regulation of business could be required to pass a private sector test, viz. would that sector likely do it better and/or would this regulatory policy likely inhibit its growth?

Of course, some of the policies pursued by the Queensland Government, such as below average levels of state taxation and budget outcomes that are financially responsible, are conducive to a favourable environment for private investment. But such policies have been in place for many years. The need now is to move to the next stage of more positively promoting the role of the private sector in areas traditionally regarded as the preserve of government.

It is beyond the scope of this report to examine government activities in the same depth as the 1996 audit, which was serviced by a sizeable secretariat. The report is thus focussed mainly on comparisons of service levels between Queensland and other states and on the scope for increasing the private sector’s role in the provision of major services where government is now the principal provider. Queensland’s private sector already has a not inconsiderable and growing role in the provision of such services, but one that is too little acknowledged let alone acclaimed. Greater recognition is needed and greater attention needs to be given to helping speed up the process that is already underway.

The basic rationale for this proposal is that the provision of the relevant services through a more competitive framework, and the expansion of the private sector more generally, would benefit the consumers of those services and Queenslanders generally. Whether assessed in terms of economic prosperity or social well-being, a reduction in the government’s involvement in service delivery and the regulation of business should help improve these standards through improved efficiency and quality. It would, moreover, reduce the cost of government and hence the level of

⁴ This is illustrated by the Government’s response to problems in the public hospital system – additional spending and full page advertisements seeking to convince people that there are no inherent problems with that system.

⁵ As pointed out by Mr Steve Vamos, director of Microsoft Australia and chair of the Business Council of Australia’s task force on education, “greater awareness needs to emerge of the impact of wider policy settings on innovation, including the impact of taxation policy, the regulatory environment and workplace relations requirements” (“Smarten up our act on innovation”, Australian Financial Review, 16 March)

taxation. Government expenditure would be smaller but in its place would be an alternative yet more efficient and higher quality way of delivering essential services wherever that is practicable.

As indicated by the Audit Commission's recommendation, there is nowadays a much reduced need for government itself to be the actual provider or supplier of services. Indeed, whether through various forms of privatisation and public/private partnerships or through natural growth in demand for private sector services, within Australia and overseas there has in recent years been something of a restoration, albeit still relatively limited, of the earlier role of the private sector. All the signs are that this will continue: educated societies generally prefer the increased choices that emerge from a competitive private sector.

This is not to suggest that government would or should fade away. Aside from public goods (where the government sector necessarily has the main role), State governments have important functions that include supplementing "normal" private sector spending if net spin-off benefits or externalities can be clearly identified for the community at large, such as from having a more educated society. Similarly, it may be appropriate for governments to regulate private sector activity where no natural incentive exists to maintain a competitive framework or to protect the environment from unnecessary damage. State government activity is also warranted to provide various forms of welfare to lower income and disadvantaged groups, including through the subsidisation or free provision of various major services. But, once increased choice and competition in the provision of such services are accepted as appropriate and desirable, governments will have a reduced role in that area, with beneficial resultant reductions in costs and improvements in their quality and effectiveness.

The challenge posed by this report is to all State political parties to recognise that State government action along the lines outlined will be beneficial to residents (and visitors) – and to follow through with appropriate measures. Of course, the Federal government also needs to improve its policies where they unnecessarily intrude on or overlap with the provision of services by states.⁶ But State governments are all too often inclined to suggest that inadequacies in their services are due to lack of federal funding or conditions imposed by Canberra. Once the potential for a greater private sector role is recognised much can be done at the state level without changes in federal policies.

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⁶ See Moore, Des, "Commonwealth Spending (And Taxes) Can Be Cut – And Should Be", Australian Chamber of Commerce and Industry, May 2005.

Developments in the Role of Government

Developments in the Role Of Government

The period after World War II saw a major expansion in the role of government in most western countries. This was partly a reaction to the 1930s depression and the belief that governments needed to counter a perceived inherent tendency for markets to experience business cycles. The then dominant socialist philosophy also saw governments as more cost efficient mechanisms for supplying basic services such as health and education to the general population and in particular to lower income groups. In consequence, the provision of goods and services by governments grew well beyond traditional areas and a much expanded “welfare state” role was developed to assist those perceived as poor and disadvantaged. Taxation levels rose sharply, fuelling the expansion of public sectors.

Notwithstanding these developments, Australian governments grew less than in almost all OECD countries and, since the peak reached in the early 1990s, their relative importance measured in terms of total general government outlays⁷ has declined by about 4 percentage points of GDP. Assessed in this way, amongst OECD countries Australia had in 2005 the second smallest government sector at 36 per cent of GDP.

Our smaller government mainly reflects Australia’s greater emphasis on means testing for social benefits and the retention of a larger private sector role in the provision of services such as education and health. For a time, this attracted some criticism on the ground that “small” government meant less resources being devoted to these services. But such criticisms overlooked their greater *private* provision than in other countries.

Critics have also had to face the fact that the reduction in the role of government in Australia has been accompanied by a much faster rate of economic growth. Since the early 1990s real income per head has increased by more than 2.5 per cent pa compared with only 1.4 per cent pa in the 1970s and 1980s. While this improvement reflects a range of factors, it makes it difficult to argue against smaller government.

Just as the relative size of government has declined in Australia so too has it declined in most OECD countries. General government outlays were reduced in 23 of the 28 OECD countries between 1995 and 2005, in 12 by more than 5 percentage points of GDP.⁸ Particularly noteworthy were the large reductions in countries previously thought to be exponents of big government, such as Sweden, Norway and Denmark. The decline in public enterprise sectors has also been marked, with over 15,000 privatisations world-wide in the last twenty years.

While since the early 1990s the size of government in the United States has been relatively stable at around 36-37 per cent of GDP, that country has come increasingly to be seen as a small government model likely to help growth. With average per capita income levels about 25 per cent above the next highest in the OECD, relatively low unemployment, and a society providing considerable individual freedom, the US framework compares favourably with the “bigger” government approach still existing in Europe. Interestingly, Canada seems to be recognising the virtues of the model of its next door neighbour and now has a total government sector, federal plus provinces (which account for about half of total government expenditure), at less than 40 per cent of GDP – a reduction of no less than 14 percentage points of GDP since the early 1990s.

⁷ For purposes of the data published in its annual Economic Outlook the OECD includes in the general government sector a consolidation of accounts for the central, state and local governments plus social security. Total outlays are defined as current plus capital outlays.

⁸ Some of these reductions, both in Australia and overseas, reflect the effect of lower interest rates on debt servicing rather than reduced discretionary spending.

The various influences behind these moves towards smaller governments are relevant when considering possible further extensions. They include:

- The considerable improvements in average living, education and health standards have increased the capacity of most individuals to manage their own affairs with less involvement of or assistance from governments;
- The increased recognition of the “deadweight losses” associated with taxation, that is, the adverse effects on the economy resulting from the deterrence to individuals or companies from taking action to increase incomes, as well as the administrative costs of tax-and-spend policies;
- The establishment of a more competitive framework in which the private sector operates has increased the protection of consumers against monopolistic practices and widened the choice of products and services. This has drawn attention to the more limited capacities of monopoly type governments to supply goods and services efficiently and at a good quality. Their inherent difficulties in this regard reflect the necessarily more limited internal competitive framework of bureaucratically run organisations and the tendency for such organisations to have centralised decision-making processes that have limited flexibility in responding to consumers and generally restrict choice;
- The pivotal role of technological change and the major contribution the private sector makes to initiating and applying such change across a wide section of the economy;
- The increased attention by the media and other bodies to government spending decisions in response to representations by particular interest lobby groups rather than giving priority to the interests of the wider community. Associated with that have been the many failures of politically determined government ventures⁹ and an increasing recognition that judgements as to spending priorities might more appropriately be made by individuals in the private sector on the basis of lower rates of taxation;
- The realisation that, while government must be the prime determinant and main supplier of “public goods” such as defence, foreign relations and law and order, the private sector can also be an important alternative supplier even in this area. Public goods type services provided by the private sector include defence maintenance, security, foreign trade and mediation – and extend even to gaols.

Although the size of government in Australia has been relatively stable in the last few years, against this background it would be surprising if the trend towards smaller government were not to continue into the future. It is not irrelevant to recall that, in the late 1960s when significantly lower living standards might have been thought to require “big government”, Australians were coping quite successfully with a general government sector that was then about 9 percentage points of GDP smaller than it is today.¹⁰ Australians have considerably greater experience than almost any OECD country with the provision by the private sector of services such as health and education and this makes such services more readily accepted here than in, say, Europe. In the current context, it is significant that, whether at the federal or state government levels,

⁹ Many private sector failures occur too: indeed it is a necessary part of the entrepreneurial system that risks are taken and failures occur. But private sector enterprises are accountable to shareholders and regulators and, if decision-makers make wrong decisions, share prices fall and there is often a loss of jobs or even criminal court cases. Governments are accountable to voters for their failed ventures but no signals are sent via falls in the price of assets and all too often the decision-makers do not lose their jobs because of such failures. Explanations for failures include that they reflected “political” decisions that were motivated by “social” as well as economic objectives

¹⁰ Under the Menzies Government from 1949-50 to 1965-66 real GDP per capita increased at the same rate (1.9 per cent pa) as during the Hawke-Keating Government from 1982-83 to 1993-94. In 1969-70 general government outlays were 24.5 per cent of GDP; in 1993-94 they were 36.8 per cent of GDP. In today’s dollars 9 percentage points of GDP is equivalent to nearly \$80 billion.

Developments in the Role of Government

there appears to be little support from left of centre political parties for lifting the level of taxation in order to finance additional government expenditure: indeed the balance of opinion in that quarter seems if anything to favour a lowering of tax levels. Further, amongst state Labor governments there was unanimous agreement at the Council of Australian Governments meeting on 10 February to a national economic reform agenda designed, inter alia, to improve health and education outcomes; to increase competition in the energy, transport and ports markets; and to reduce the regulatory burden on businesses. The 2005 publication by the Victorian Labor government of a paper advocating a third wave of economic reform paved the way for this agreement.

The foregoing developments in the relative role of governments provide a setting that should be favourable to measures towards improving the functioning of the economy and society more generally by further increasing the role of private sectors. Scope certainly exists to expand that role by introducing a more competitive framework in areas where State governments are now the major producers or the direct suppliers of services, including in areas such as education, health, public transport, roads, ports and housing.

The form in which the private sector might participate can vary from outright privatisation to franchising/contracting out and public/private partnership arrangements of various kinds, including those in which asset ownership remains with the government.¹¹ The ultra-cautious approach to such arrangements adopted by some governments, including the Queensland government, appears to have little substantive basis other than the preservation of political power and it risks unnecessarily holding back economic and social development.

Indeed, the various objections expressed to increased private sector involvement appear themselves to have little substantive basis and often appear to originate from vested interests whose powers and/or influence would be adversely affected. Doubts, for example, as to whether sufficient expertise exists within the public sector to negotiate projects with the private sector that protect the taxpayer against acceptance of undue risk overlook the availability nowadays of many consultants to advise on such matters. Further, arguments that governments are able to finance capital expenditure by borrowing at lower rates than the private sector neglect the likelihood that use of the latter generally results in a more efficient use of capital in a more competitive environment:¹² if that were not the case societies would be voting for governments to take over the running of most private businesses. And the existence of more contestable markets and competition regulatory authorities means that consumers are more protected against monopolistic practices than when enterprises are run as government monopolies.

Equally, although unions often resist private sector involvement on the ground that employment will be reduced, there is no evidence that the overall level of employment is adversely affected in countries or states where there is greater private sector involvement in public service type activities: rather the contrary. Of course, some existing employees may lose their jobs and need assistance, just as they may when private enterprises change ownership. But the possibility of the loss of specific jobs should not be a determining factor against reforms that are likely to result in the provision to the wider consumer population of higher quality services at a lower cost, as well as leading to faster job growth overall.

There are many successful examples in recent years of the increasing involvement of the private sector in the provision of infrastructure services. Victoria has undoubtedly benefited from the improved efficiency resulting from the privatisation of electricity and some ports, the franchising

¹¹ Under BOO projects (Build Own Operate) the contractor retains ownership and the government only agrees to purchase the services for a fixed period while under BOOT projects the assets are transferred back to the government after a certain period.

¹² When governments engage in commercial activities such as transport and energy the risk and the cost of capital will be similar to that for the private sector unless there is a specific government guarantee. In a paper on Privatisation of Public Assets prepared in 1999 for CEDA, Professor Bob Officer points out that claims that the cost of capital is less for government for comparable assets are "based on either a logical error or an empirical fallacy".

of metropolitan public transport and the BOOT project for the Melbourne City Link started by the Kennett government. These arrangements have all been kept in place under the Bracks government, which is itself also making extensive use of public/private partnerships including for roads (for further details, see Statistical Appendix on Public Investment and Public Corporations).

In NSW in addition to undertaking roads projects with the private sector the government has started to employ it in education projects. In 2004-05 a private sector firm financed, designed and constructed nine schools for which it is also providing cleaning, maintenance, security, furniture, equipment and grounds maintenance. At the end of 30 years the state government will again assume responsibility for the schools. According to a report by the NSW Treasury,¹³ the schools were built two years earlier than would have been possible under a traditional public sector contract and the school principal has been relieved of much facilities management. The firm has recently won a similar contract for a further nine schools.

Overseas countries have also introduced or are introducing reforms along similar lines. In education, for example, Swedish parents have since 1992 been able to use public money to send their children to any school that meets certain minimum requirements.¹⁴ The resultant expansion of independent schools in the state system has been dramatic, increasing from 90 in 1992 to 1,000. Some American states also have charter schools operating on the same general basis. In the UK, although the original (2005) proposal by the Blair Government for new state schools to be established as independent trusts, and for existing schools to be encouraged to become trusts, has been watered down, the substantive elements of it appear to be proceeding including, inter alia, the legislative authorisation of the exercise of disciplinary powers by teachers.

A continuation of private sector involvement along these lines could eventually lead to a situation in which, while certain services made available by the government sector would continue to be financed by governments, they would be all be operated by independent institutions run by private enterprises that would compete to supply such services. Governments could decide, for example, how much funding they would make available for education and healthcare services, and on what conditions, but those services would be delivered by the private sector and governments might thus over time cease to directly employ teachers or medical personnel.

In Australia, while the delivery of government school and hospital services (the two largest items of expenditure by state governments) *per se* is not open to private sector competition,¹⁵ those services are exposed to competition from services delivered by the private sector, with one third of students attending non-government schools and nearly forty per cent of hospital separations occurring in private hospitals. However, such privately delivered education and health services would not be nearly as extensive but for the considerable supportive funding provided by governments: government grants provide nearly 60 per cent of the income of non-government schools and around 35 per cent of the funding of private hospitals is also sourced from governments, mainly by indirect means through rebates in respect of premiums paid by contributors to health insurance funds (for further details, see Health section in Statistical Appendix). This funding means, in turn, that the cost to governments, and hence to taxpayers,

¹³ "New Schools Privately Financed Project Post Implementation Review", NSW Treasury, Office of Financial Management, Research and Information Paper, December 2005. According to the review, the risk adjusted cost of private sector delivery over the 30 year life of the project was \$131.4 million, an estimated saving of just over 7 per cent compared with the most likely scenario for public sector delivery.

¹⁴ A similar situation exists in Denmark, Ireland and the Netherlands. Other countries/ states, such as Chile, the Philippines, Milwaukee and Cleveland fund voucher schemes.

¹⁵ Of course, some components of these services are provided by the private sector through government purchases of equipment and the contracting out of some services.

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of the services they deliver is commensurately reduced by comparison with the situation where there were no privately delivered services.¹⁶

In some respects this might be said to be a rather contradictory situation: governments recognise the merits of privately delivered school and hospital services and help add to those competitive services but do not allow the private sector to be involved in the services that they deliver themselves. Logic would suggest that government delivered services should be opened to competition too.

In Queensland the government thus has the opportunity to start disengaging from direct service delivery on the condition that certain standards and procedures are met, with the potential for reducing the cost of service delivery and increasing the quality. It might at the same time also encourage the expansion of privately delivered services both by providing additional financial resources on a competitively neutral basis and by facilitating the establishment of such services to the maximum extent practicable. Most existing Queensland government owned corporations could also be privatised on the basis that they would operate in a contestable market and be subject to competitive regulation and that, while allowed to operate profitably, would administer subsidies provided by government for certain services.¹⁷ Such policies can be pursued by Queensland independently of any changes to federal-state arrangements, although agreement to change those arrangements to move, for example, to deliver an increasing proportion of hospital services through the private sector would obviously be consistent with the establishment of a more competitive environment for service delivery.

¹⁶ According to the executive director, Australian Private Hospitals Association, nearly 4 million of those with insurance coverage earn less than average weekly earnings (see Michael Roff, "Private hospitals deliver good value for money", Canberra Times, 3 March 2006). Low income groups without coverage have free access to public hospital treatment.

¹⁷ Such as for public transport and for the use of some services by low income groups.

Existing Roles of Government & Private Sectors in Queensland

Spending by the Queensland public sector¹⁸ currently contributes about 20.5 per cent to total final domestic demand in the state, which represents a significant reduction on the 23.7 per cent in 1991-92 (Table 10 in Statistical Appendix). However, although since the early 1990s there has been such a reduction in the public sector in every state, the contribution in Victoria has been reduced by considerably more than in Queensland – from 24.5 per cent to 19.4 per cent – and Victoria’s public sector currently makes the smallest contribution to growth. That is due mainly to that state’s more extensive privatisations. The contrast with Queensland is striking: the Queensland Government still has 20 government-owned corporations (GOCs), valued at \$22 billion, that operate ports, railways, and electricity – and has so far concluded only one PPP.¹⁹

Although there is no proven direct correlation between changes in economic growth and the size of the public sector, there is a substantial academic literature suggesting a negative relationship does exist between the size of government and economic growth.²⁰ Accordingly, it seems likely that the downward trend in the public sector’s role in Queensland since 1997-98 would have helped contribute to the increase in real income per head of 3 per cent per annum, faster than in any other state. By contrast, in NSW, where the public sector has performed poorly and stayed virtually stable over this period, growth in per head real income was about half Queensland’s and the slowest amongst the states. In Western Australia a major *increase* in the relative size of the public sector was accompanied by a slowing in per head income growth which pushed it down to third after Victoria in the states’ growth pecking order.

Table 9 in the Statistical Appendix compares the main changes (in real terms) in the private and public sectors in Queensland since 1997-98, viz.:

- Total public sector spending (consumption plus investment) increased at a much slower rate than the rest of the economy;
- Although Queensland has maintained public sector fixed capital investment²¹ at a higher proportion of GSP than in any other state, that proportion declined from 5.4 per cent to 4.8 per cent in 2004-05;
- Business fixed capital investment expanded about 3.5 times faster than total public sector investment and increased from 67.5 to 75 per cent of total investment (excluding dwellings) in the state in 2004-05;
- Overseas exports made a surprisingly small contribution to growth, increasing at a much slower rate than overseas imports and GSP. Including the balancing item (which shows the net effect of *intra*-state trade) there was a significant increase in the net *negative* contribution to growth from Queensland’s external transactions. This increase in the state’s *de facto* current account deficit presumably largely reflected the increased imports

¹⁸ Public sector in this context includes public corporations and local government.

¹⁹ However, the Government has announced that the \$1.5 billion airport road link in Brisbane in 2008 is expected to be a PPP.
²⁰ See, for example, the April 1998 report by the Joint Economic Committee of the US Congress on “The Size and Functions of Government And Economic Growth.” And Professor Denis Mueller’s analysis in “Public Choice III” of various academic studies on the effects of government size suggests that, while too small a government sector can harm economic performance, beyond some point the adverse incentive effects from high levels of taxation and regulation outweigh its positive effects. All of the highly developed countries, Mueller concludes, are beyond the point.

²¹ Public sector investment includes investment by the federal government in the state. Of course, the influence of government on economic activity is determined by more than just its size.

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emanating from the strong growth in investment and reflecting the sparsity of local supply for large scale processing projects.

The foregoing highlights business investment as the driving force in Queensland's faster growth and adds weight to the perspective that a policy directed at emphasising the private sector's role should help lift growth further. It also raises a question as to whether, in the circumstances of such a strongly growing economy, the relatively slow growth in public sector investment provided adequate supportive public infrastructure.

Unsurprisingly, private sector employment has also increased strongly. Since 1997-98 private employment has increased by 3.1 per cent per annum (Table 20), considerably faster than the growth of 1.8 per cent pa in total public sector employment in Queensland. However, the increase in public sector employment has been faster than the average for the states (1.5 per cent pa) and such employment is now a higher proportion of total employment than that average (Table 20): if it was reduced to the states' average that would require a reduction of about 8,000 or 3.3 per cent from the existing 239,500 in 2004-05.

The *public service* component (about 194,000 in 2004-05) of public sector employment (Table 21) appears to have grown considerably faster (3.4 per cent pa) than total employment in that sector, with relatively rapid increases in employment in the departments of Education and Transport, and in Police. The increase in employment in Premier and Cabinet (3.0 per cent pa) to 568 in 2004-05 is suggestive of an increased centralisation of decision-making.

Gross earnings of Queensland public sector employees (Table 22) have also increased slightly faster than the average for the states (6.1 per cent pa compared with 5.7 per cent pa). However, the average per employee level of such earnings in 2004-05 was about 3 per cent below the states' average (Table 23) and almost 12 per cent below the state with the highest level (NSW).

Nearly 60 per cent of Queensland public sector employees are members of trade unions compared with only 19 per cent of private sector employees. While the traditional opposition of unions to a competitive labour market adds to the difficulty of adopting policies designed to increase the role of the private sector in the delivery of government services, this situation also points to the potential for benefits from such reform. In the public sector union membership is strongest in education, government administration, health and transport but relatively low in electricity, gas and water supply (Tables 24-25).

Queensland's General Government Sector

ABS data on spending by the *general government* component of the public sector (ie excluding government corporations and local government) between 1998-99 and 2004-05 shows that it also increased in nominal terms at a slower rate than GSP – 6.4 per cent pa compared with 7.8 per cent pa (Table 15).²² Spending on health and education services, which between them account for nearly half of all spending, grew at a slightly faster rate than total spending by the sector. The fastest growing area of spending (19.4 per cent pa) was on “general public services”, which covers a rag bag of items including administration, general scientific research and regulation.

Commonwealth Grants Commission (CGC) analysis confirms that the Queensland Government has not been a “big spender” in the general government sector. That institution's assessments show that spending by that sector has generally been maintained at levels lower than the states'

²² ABS spending data by function for the general government sector is only available on a consistent accounting basis for this period.

average (Table 16).²³ CGC assessments for 2004-05 indicate that total expenditure was then below average to the extent of about \$2.8 billion. However, a major part of this below average spending reflected a *negative* amount of spending arising from increased earnings from superannuation and other investments by the Queensland Investment Corporation (the CGC deducts such earnings from expenses for both superannuation investments and debt charges).²⁴ Excluding the net effect of superannuation and debt charges, total expenditure of \$17.3 billion was \$939 million below average, equivalent to about 5.2 per cent of such spending.

The CGC assessments show that the major spending areas below average in 2004-05 were hospitals (\$759 million), vocational education (\$202 million), aged and disabled services (\$260 million) and urban transit (\$149 million). The large increase in spending on hospitals announced in the mini-budget of October 2005, and the further additions since in both health and vocational education spending, will have brought spending in these areas closer to the states' average.²⁵

The main areas of above average spending assessed by the CGC were roads maintenance (\$53 million), non-urban transport (\$82 million), petroleum subsidies (\$391 million), electricity/gas (\$155 million), general public services (\$407 million) and non-government schools (\$58 million). Compared with 1997-98 spending on electricity and gas subsidies was more than twice as high, on "general public services" nearly three times as high, and on petroleum subsidies about 70 per cent higher.

Queensland Treasury advised that, while it was unable to identify specific reasons for the higher expenditure on "general public services" (which cover a large number of items in the Grants Commission's assessments, including support for research and outlays on parliament and ministerial departments), the higher subsidies on electricity/gas and petroleum reflects government policy decisions.²⁶ These three areas, however, provide potential for savings to be effected and used for other purposes, such as tax reductions.

Savings potential may also be identified by the independent (and statutory) Service Delivery Commission, reporting direct to the Premier, established in the mini-budget "to ensure government services are effectively meeting the needs of the community". In announcing the establishment the Premier indicated that the minimisation of duplication and inefficiencies is expected to provide savings of \$20 million in 2007-08, rising progressively to \$100 million by 2010-11. Opportunities for implementing efficiency changes could include the non-retention of a Government Printer, the purchasing functions and the centralised maintenance workforce in the public works department, as well as incentives provided to business investment from outside the state.

Under the Grants Commission's methodology, whether expenditure on a particular service is below or above the states' average may reflect either a difference in the efficiency with which a service is supplied or a difference in the government's policy regarding the appropriate standard of services more generally. In that latter regard a trade off is inevitably involved: a

²³ Comparisons with the average in this context are comparisons with the spending level assessed by the CGC as needed if the State is to reach the average level for the States. For this assessment the Commission takes account of additional (or lower) costs not due to policy differences, such as Queensland's more dispersed population, that have to be met to reach that average level. As noted, in Queensland's case the overall additional amount reflected in the State's share of GST revenues is only 1-2 per cent of total revenue.

²⁴ The QIC manages investments on Treasury's behalf to meet long term contingent liabilities such as superannuation and long service leave in the public service. Its investment earnings are thus notionally hypothecated for those purposes and, as such, are not available to finance other spending.

²⁵ Estimated new health funding was \$431 million in 2005-06, followed by \$610 million in 2006-07 and \$631 million in 2007-08. Since the mini-budget pay increases for doctors and nurses have added a further \$1.3 billion over three years and an additional \$600 million is to be expended over four years on vocational education.

²⁶ The Treasury also advise that the accuracy of data included in some of the CGC calculations is in dispute. Specific reference was made to the length of roads.

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state may deliberately decide to operate, for example, at a lower than average level of services in order to have a lower than average level of taxation. Prima facie, the residents of a state benefit, on average, more from that option rather than the higher spending option.²⁷

In Queensland's case the government has up to the present time continued the "low tax" strategy adopted by its predecessors and advertises this as a deliberate policy. CGC analysis for 2004-05 shows that Queensland had the least severe tax regime of any state, with actual tax revenue about 14 per cent below what it would have to raise if rates were as high as the average of the states (Table 16). This was equivalent to savings in taxes of \$1,068 million (about 16 per cent of actual tax revenue of \$6,676 million) or \$270 per head. However, as discussed below (see "Queensland's Budgetary Outlook"), recent increases in spending, and an apparent deterioration in the budgetary outlook, raise a question as to whether this low tax policy can be sustained in circumstances where expenditure growth will otherwise have to slow.

The three main sources of Queensland tax revenue are payroll tax (25 per cent), stamp duties on conveyances (23 per cent) and motor vehicle taxes (15 per cent) (Table 28). The proportion of tax revenue coming from these sources has increased since 1999-00 to, in effect, replace the revenue lost from the cessation of franchise taxes in that year following their declared invalidity.

The major change in Commonwealth/State relations, under which from 2000-01 the federal government substituted payments of GST revenue for general revenue grants, has also helped reduce the severity of state taxes. Although the Queensland Government opposed the introduction of the GST, the GST revenues paid to the state (and to other states) have more than compensated for the elimination of general revenue grants and the abolition of certain inefficient state taxes. Thus from 1999-00 to 2005-06 (est) the proportion of revenue Queensland raised itself has dropped from about 54 to 52 per cent and the "burden" of state taxes has fallen from 4.8 to 4.1 per cent of GSP (Table 26).

²⁷ Arguably, lower taxes increase choice by increasing disposable incomes and allowing residents to have higher personal spending levels.

The Performance of the Queensland Economy

The Appendix on Achieving Sustained Economic Growth examines in more detail the policies most likely to maximise growth in Queensland and the shortfalls in the policies adopted in recent years. It suggests there is considerable scope for improvement.

The major immediate cause of Queensland being the fastest growing state in real terms since 1997-98 (5 per cent pa compared with 3.5 per cent pa for Australia) has been Queensland's much faster growth in population than the average (2.2 per cent pa compared with 1.3 per cent pa for Australia), reflecting increased migration from other States and overseas (Table 1). Queensland's economic growth has even exceeded (by over 1 per cent pa) the growth rate in the state that has attracted the most mining investment - Western Australia (Table 3). However, the "growth gap" in favour of Queensland and other states in overall rates narrows when per head income rates are considered (Table 4).

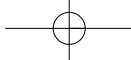
Real Growth Per Cent pa - 1997-98 to 2004-05

	Queensland	Australia	Differential
Total GSP Growth	5.0	3.5	1.5
Per Head GSP Growth	3.0	2.3	0.7

As already noted, although there has been some convergence in average real per head income *levels*, that level in Queensland remains well below that in Western Australia, Victoria and NSW – ranging from 19 to 12 per cent lower in 2004-05 (Table 4). The reasons for this are not completely clear. It is sometimes said that it partly reflects higher proportions of retirees and hence fewer workers. However, the proportion of the population of working age (15-64 year olds) in Queensland in 2003-04 was about the same as the average for the states and higher than in any state bar one (Table 2). And its labour force participation rate is actually well above average (Table 12).

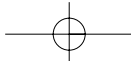
A major explanation of the per capita income differences may possibly be found in Queensland's industry structure (Table 14). The much higher contribution to total production of the mining industry in Western Australia (18 per cent compared with 5.4 per cent in Queensland) almost certainly explains, for example, that state having an average per capita income 19 per cent higher than in Queensland. However, contrary to common perceptions, Queensland is not primarily dependent on a bunch of generally low income farmers: the agriculture sector contribution to total production is just over 4 per cent, only slightly higher than the average for the states. The main downwards influences on relative average per capita incomes in Queensland appear to come from the lower than average production contributions by the finance and property/business industries (where wage levels would generally be relatively high) and the higher than average contributions by the construction, retail trade and accommodation, etc industries (where wage levels would generally be lower than average). A slight downward influence on relative income levels may thus be exerted by the proportionately larger role of tourism in the economy (which is doubtless reflected in the higher than average production contributions by the latter two industries in particular) and by the housing and other building demands of the faster growing population.

The potential for the Queensland Government to reduce the per capita income differences between Queensland and other states by influencing changes in industry structure is thus



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obviously very limited in the short term: the private sector is responding to the existing resource and population situation in the state. However, a policy of maximising the attractiveness of investment conditions in mining, such as through minimal regulation and adequate infrastructure, would encourage development in that relatively high income industry. The higher than average contribution by “government administration” and “general government” also raises the possibility of increasing the average level of per capita incomes through increasing the relative role of a more efficient private sector in the delivery of government services.



Queensland's Budgetary Outlook

The increase in net expenditure in the October 2005 mini-budget reduced the estimated/projected operating surpluses to the point where they would range between only \$140-250 million pa in the next three years, thereby leaving very limited funds available from the budget to finance capital expenditure in the general government sector. Moreover, since the mini-budget the Government has announced additional health expenditure totalling around \$1.3 billion over three years and additional expenditure on vocational education of \$600 million over four years,²⁸ which suggests that these operating surpluses will have now disappeared. This in itself need not prevent adequate capital expenditure but that would now have to be financed from borrowings.²⁹ However, the generation that most benefits from the social-type capital expenditure by general government sectors should be primarily responsible for providing the resources for such expenditure, not passing that responsibility on by borrowings that the next generation has to repay.³⁰ Accordingly, it would be fiscally (and morally) responsible for Queensland to return to operating surpluses of around 1 per cent of GSP, or in the region of \$1.5-2 billion.

Of more immediate significance is the prospect that a major slowing in the growth in Queensland budget revenue in the next three years could in turn significantly limit the capacity to finance recurrent expenditure on government services. As indicated in Table 26, total state revenues are projected in the mini-budget to increase over the next three years at only 4 per cent pa, considerably slower than the projected increase of around 7 per cent pa in nominal GSP and, equally, much slower than the growth in total revenue of just over 7 per cent pa from 1997-98 to 2005-06.

On the basis of existing policies Queensland thus faces the prospect either of expenditure on major services growing at a much slower rate than the economy or of having to increase taxes to make up at least some of the difference. By way of illustration, if the projections of revenue are realised Queensland would have about \$2.7 billion or 9 per cent less revenue in 2008-09 than if the trend over the past eight years had continued. To obtain the additional revenue would require a one-third increase in State taxes. But given the need to retain Queensland as a low tax state as part of a policy of attracting business investment, other options should clearly be preferred.

The marked slowdown in the projected growth in total revenue reflects three main potential influences.

First, Queensland is projecting a slightly slower rate of (real) economic growth from 2005-06 to 2008-09 than occurred in the seven years to 2004-05 – 4.5 per cent pa compared with 5 per cent pa.

Second, with GST revenues increasing over the five years from 2000-01 to the current year at an unsustainable rate of 10.3 per cent pa,³¹ it is scarcely surprising that federal budget projections of GST revenues now suggest a marked slowing in the rate of growth of revenue received by Queensland from this source. Thus these projections for the next three years

28 On 14 February the Premier announced an increase in pay for senior doctors costing \$272 million over three years and on 3 March a 25.3 per cent increase in nurses pay costing \$1 billion over three years.

29 Queensland's strong balance sheet - it holds financial assets more than sufficient to cover liabilities of the general government sector - would accommodate considerable borrowings without adversely affecting the State's AAA credit rating.

30 In his "Public Principles of Public Debt: A Defence and Restatement" (1986), US economist James Buchanan (who subsequently won the Nobel Prize for Economics) rejected the idea that the creation of public debt does not involve any transfer of responsibility to future generations. He pointed out that such debt does constitute a burden on future generations because they have to find or allocate the resources to service it.

31 Final consumption expenditure increased over the same period at a rate 4-5 percentage points slower than this but is now expected to grow at an even slower rate.

(which assume a reduction in Queensland's share of GST revenues and which the Grants Commission assessments for 2006-07 have confirmed) indicate an annual increase averaging about 4 per cent pa.

The following table compares the projected outlook with the GST bonanza that Queensland (and the other states) have experienced hitherto.

GST Revenue Provision (Cash)

	States & Territories % Increases	Queensland % Increases
2001-02	9.3	7.7
2002-03	14.4	17.3
2003-04	9.0	11.3
2004-05	6.3	11.8
2005-06	3.9	3.6
2006-07	6.7*	5.1*
2007-08	5.4	3.9
2008-09	5.2	3.1

* The estimate for total payments by the federal government (ie including specific purpose payments as well as GST revenues) shows a 3.3 per cent increase for all states and territories and a 2.2 per cent increase for Queensland.

Source: Meeting of the Ministerial Council for Commonwealth-State Financial Relations and the Australian Loan Council, Press Release by Treasurer Peter Costello, 1 April 06.

Third, in accordance with the Intergovernmental Agreement on the Reform of Commonwealth-State Relations (IGA), Queensland has agreed to abolish a number of minor State taxes in addition to those already removed.

It is possible that the projections of revenue, particularly from the GST, are on the conservative side. Even if that is the case, however, without a change in existing policies the Queensland Government faces the likelihood that budget expenditure on government services will now have to grow at a considerably slower rate than the economy. Such a prospect clearly adds to the desirability of adopting a deliberate policy of encouraging the private sector to assume an increased role in the provision of such services. Indeed, such an increase may be the only viable option if the evident growing demand for higher quality services in health, education and transport is to be met.

This outlook invites consideration of an agenda for public policy over the years ahead to cope with this growing demand.

How the Private Sector's Role Can be Increased

Reference has already been made (see “Developments in the Role of Government”) to the potential for the Queensland government to initiate policies to increase the role of the private sector. The basic rationale is that the resultant increase in competition would provide users of the services with the choices that educated societies are increasingly wanting. Moreover, as indicated by the expanding use of *priced* private sector services in the face of (largely) *free* public services, those users of private services are clearly concluding that the benefits from competition - higher quality and more assured outcomes - outweigh the costs. And, because these outcomes are tested in the market, the users have access to a form of accountability that quickly challenges poor private sector performers to take corrective action (or suffer the consequences), whereas such tests are generally lacking in the public sector. Indeed, government services not only experience less testing pressure to respond but publish more limited data on their performance, particularly the individual units, and are often faced with resistance from unions to making such information available.

Accountability seems particularly lacking in Queensland where the government appears to have deliberately held back information regarding the performance of government services.³² Nor has the absence of an Upper House and an Estimates Committee in that house been conducive to accountability. This situation would be improved if an Upper House were to be re-established on the basis of no increase in the number of parliamentarians but with second chamber terms twice the length of lower house terms (see Appendix on “Enhancing Public Accountability of Queensland Government”).

The suggestion is sometimes made that increased competition in the provision of government services would lead to “competition to the bottom” that will force low income users to accept lower service standards. However, this is clearly a myth, as is evident from the vast increase in both the range and quality of consumer goods and services produced by competing private sector enterprises over recent years. Moreover, a competitive framework is well able to provide good standards of services to low income groups if the providers are subsidised: the cost of most government services to low income users is of course already subsidised under existing arrangements and a competitive private sector can be better providers of such subsidised services (as it is now in, for example, providing metropolitan transport services in Victoria).³³

There is no doubt that users of major state government services have been voting with their feet and would move out much faster if there was a reduction in the regulation of private providers and in the “gap” between free and charged for services. This would not only improve the satisfaction of consumers (aka the electorate) – over time it would also improve Queensland’s budgetary situation. However, the situation should be tackled in two ways, viz.

³² It appears, for example, that there is a history of Queensland governments avoiding responses to freedom of information requests by, in effect, re-classifying documents as Cabinet-in-confidence. Amongst the changes in health policy in 2005 the government has undertaken to publish the performance of individual public hospitals. By contrast, in the government’s comments on the education section of the Productivity Commission’s “Report on Government Services 2006”, it went no further than stating “Queensland will publish annually a broad range of Year 12 outcomes and student destinations.” In NSW the government has given an undertaking to publish details of the performance of individual government schools.

³³ In the Queensland school system the independent sector includes 5 schools catering for indigenous students and 4 schools specifically catering for disengaged or at risk students. State recurrent funding for non-state schools gives some priority to schools taking disadvantaged children but considerably less than the total cost. Anti-discrimination legislation also makes it illegal on various grounds, including learning disabilities, for schools to refuse enrolments. In any event, contrary to the debate on the Blair reforms (where opponents argued that the trust schools would create a “two tier” system, with low-achieving students getting the “bad” schools and competition leading to “empowered” schools not admitting such students), Australia already has a system in which government schools compete with non-government schools and also between themselves ie the diversity within both the government and non-government systems means there are many more than two so-called “tiers”.

How the Private Sector's Role Can be Increased

by acting directly to improve the performance of government services and indirectly by encouraging increases in the proportion of such services provided by the private sector.

The first can be progressed by adopting the purchaser/provider model policy recommended in the 1996 Audit Commission report, i.e. while retaining full government responsibility for funding, commence opening up the delivery of major services by the state to competition from the private sector. This approach is outlined in some detail in Chapters two and three of the Audit report and is not examined further here other than to propose it be implemented over a period and proceed initially on a step by step basis. For example, hospitals policy could start by contracting out the provision of discrete services such as pathology and certain types of surgery.³⁴ Similarly, schools policy could contract out the kind of services involved in the NSW nine schools project and also adopt an approach along the lines of the Blair "trust" model in selected regional/local communities as a means of providing increased autonomy to schools and involving the residents of such communities to a greater extent in their local schools. Contracting out part or all of some services can also help increase the capacity to effectively manage the work force and reduce restrictive union practices - but contracts need to specify clear performance standards.

The other main approach should be to further encourage the development of competing private sector services and to adopt a policy of allowing the private sector to take over the public sector role where that appears likely to improve the efficiency and quality of services³⁵ and/or where the public sector role has ceased to be required. This has already been happening, but to only a limited extent, and the section in the Statistical Appendix on Public Investment and Public Corporations outlines the major private sector involvement in infrastructure provision.

The principal developments since 1997-98 in some major areas are as follows:

- Schools - the proportion of students attending non-government schools has increased from 28.0 to 30.2 per cent and the 196,290 students so attending in 2005 effectively saved the Queensland Government and hence the taxpayer over \$1 billion in that year;
- Hospitals - the proportion of patients treated at private hospitals has increased from 36.2 per cent to 47.0 per cent in 2003-04 (this being the highest for any state) and in that year this effectively saved the Queensland Government nearly \$1.9 billion;
- Public Trading Corporations (Banking, Insurance, Electricity, Ports, Water Supplies, Forestry, and Public Transport) - the private sector has purchased all the holdings of the Queensland Government in financial sector activities, is leasing the Dalrymple Bay Coal Terminal, and has also undertaken two BOO projects (one in a pipeline and one in electricity generation) as well as participating in two joint venture electricity generation projects. However, the principal investor (Shell) in the three electricity generation projects sold its interests apparently because of uncertainty about the government's own investment policy in regard to power generation;³⁶

³⁴ In Western Australia the present government has continued the joint operation with two private hospitals established under the Court government. The Queensland Government also indicated on 7 March that, due to a shortage of public health doctors, the operation of the emergency department at Caboolture Hospital would be contracted out to a private company for at least a year at a cost of about \$7 million. A press report (Courier Mail, 16 March) quotes the College of Emergency Medicine as suggesting that the salaries being offered by the company are significantly higher than if the service were able to be supplied through the normal public health system. However, the company claimed that they are consistent with packages paid by Queensland Health and the latter indicated that, except for a performance aspect, this was correct. It has not been made clear why the normal bypass arrangements for over-loaded hospitals could not apply. Any contracting out approach would normally apply on a wider basis than simply one hospital.

³⁵ At a federal inquiry into health care funding, barrister Tony Morris, who until replaced was head of an inquiry into the so-called Dr Death incidents in Queensland, argued that the private sector should even take over the administration of the Queensland health system (Australian Financial Review, 17 March).

³⁶ See Moran, Alan, "Gridlock?", Courier Mail, 14 March 06.

- Public Housing - the proportion of households renting from private landlords has increased from 24.5 to 26.5 per cent (in 2002-03), with renters of public housing falling from 3.9 per cent in 1997-98 to 3.6 per cent.

Relevant considerations to policies that might further encourage such developments are set out below.

Schools

Although the proportion of students attending non-government schools has been increasing at a similar rate to the states' average and is now over 30 percent, that is still well below the national average of nearly one third and Victoria's 35 per cent (Table 33). If policies were adopted with the aim of increasing the Queensland ratio over the next four years to the projected national average of 36 per cent, the net annual saving³⁷ in recurrent expenditure on the government schools system would increase from \$1,026 million to \$1,904 million in 2011 (Table 46). In addition, there would be a further reduction of around 25 in the number of government schools - they decreased by 27 over the past six years (Table 47) - which would probably yield \$50-70 million in proceeds available for other capital spending.

Changes in state policies that would help bring about this increase about would include:

- A substantial increase (say 20 per cent initially) in the total of recurrent and capital grants to non-government schools and, in due course, a switch to making the grants to parents.³⁸ This would be an increase of about \$75 million on the 2005-06 budget estimates, which provided for grants totalling \$374.1 million, with \$332.1 million for recurrent and \$42.0 million for capital purposes. While this would be a larger increase than in recent years - the 2005-06 grants are about 30 per cent higher than in 2002-03 - it would be consistent with a longer term objective of increasing the proportion of students attending non-government schools and reducing budget spending on government schools.

Advice from non-state school authorities suggests, however, that future government budgetary considerations will prevent or strictly limit further real increases in funding. This would, however, be a false economy: a major increase, together with other changes in policy outlined below, would in due course increase the rate of growth of attendances at non-government schools and reduce needed expenditure on government schools;

- Adoption of a policy of making low interest loans available, on the basis of a 50-50 "sharing" of funding, to private sector groups which satisfy appropriate credit worthy checks and have coherent plans to establish or expand private schools. This would help overcome one of the major difficulties faced by such groups, viz. the raising of initial capital for establishment or expansion, and should be readily accommodated within the state's strong balance sheet;
- Indications of a preparedness to give ready accreditation to applications to start non-government schools and to amend the 2005 Accreditation Legislation to reduce the extensive regulatory requirements which have to be considered by the Eligibility for Government Funding Committee of the Non-State School Accreditation Board.

³⁷ That is, the saving compared with what the cost would be without non-government schools. This is calculated by taking the average cost per student at Queensland government schools and deducting the average state grant per non-government school student.

³⁸ In circumstances where the government provides funding for both government and non-government schools a de facto voucher system is created. The switching of non-government school grants to parents rather than schools would create a more competitive environment within the non-government school sector and is likely to increase the choice of available schools. In due course it could lead to a similar arrangement for government school parents.

How the Private Sector's Role Can be Increased

Important changes should include ensuring that regulatory policies do not present any barriers to non-state schools adopting different curricula and testing to those used in government schools³⁹ and that delete the existing regulation requiring account to be taken of the “likely impact...on any other schools within the area.” In addition, “for-profit” schools should be eligible for grants provided their charter limits the use of any profit to spending within the school;⁴⁰

- Associated with such an approach, adoption of a policy of inviting expressions of interest from non-government schools in circumstances where population changes require that a new school be established, accompanied by an indication that, subject to there being suitable applicants, preference would be given to non-government schools;
- Similarly, adoption of a policy of rationalising by amalgamation and/or closure a significant proportion of the large number of Queensland's under-sized and/or under-utilised government schools and of being prepared to offer non-government schools the opportunity of participating in the rationalisation process.⁴¹ (Queensland has the largest proportion of government primary schools with fewer than 100 pupils – 40 per cent compared with 21 per cent in Western Australia – and, while its greater dispersion of population requires a higher proportion of small schools, advice from non-state school authorities suggests there is considerable scope to rationalise in some areas);
- Adoption of a policy of maintaining student/teacher ratios for government schools at average 2005 levels on the basis that the major reductions in recent years (Table 35), and the questionable effect of even smaller class sizes in improving education standards, do not require further reductions. Such a policy would reduce pressures on non-government schools to compete with lower ratios and would also help the government cope with the prospective budgetary deterioration.

The Queensland government has recently announced measures designed to extend school education⁴² both at the start and end of such education (see education section of Statistical Appendix). However, while this recognises the importance of investment in human capital and the satisfaction that flows from that for most people, it fails to recognise that education standards will likely be best improved by a system that is based on competition in one form or another and that individuals will need a range of treatments in the post school period.⁴³

39 Curriculum and testing standards are the subject of considerable dispute. An intensive debate arose, for example, over the Studies of Society and Environment curriculum announced by the Queensland Government in the late 1990s. However, no change was made to the curriculum. Under existing arrangements non-state schools are required to have curricula and programs which “must enable the students to at least achieve Queensland standards of learning or standards of learning comparable to Queensland standards of learning”. Queensland standards of learning are defined as that approved by the Queensland Studies Authority and the Accreditation Board would require an applicant to prove that it would be delivering such standards. This allows some departure from the “standard” curriculum for Steiner, Baccalaureate schools.

The existence of wide differences of view on curricula in itself suggests that there should be no fixed set of criteria laid down by governments other than “essentials” such as the teaching of literacy and numeracy. For further analysis of this important question, see “Education Reform Who Should Control the Curriculum?” by Kevin Donnelly, IPA Backgrounder, September 2000, where he points out that a “freeing up the schools system will have little value if all schools are made to follow the same curriculum”. See also Dr Donnelly's book on “Why Our Schools Fail”.

40 Non-government schools need to raise funds for capital expenditure and profits are one possible source of such funds.

41 For example, where there is more than one government school in an area that are clearly under-utilised, non-government school groups could be invited to tender to amalgamate such schools.

42 This may be a reflection of analyses by various authors, published in 2003 by the Queensland Treasury, on “Productivity and Regional Economic Performance”. In one section of the report it is asserted that Queensland's lower than average per capita incomes are importantly due to its smaller human capital stock which, it is argued, reflects “crucial” differences in secondary educational qualifications and the need to institute early childhood education programs. However, if additional investment in human capital is to provide tangible improvements in per capita incomes, such investment through the school education system needs to take the appropriate form. In assessing differences in per capita incomes account has also to be taken of the historical effects of “natural” differences in the structures of state economies.

43 For an excellent explanation of the reasons for pursuing this approach, see Novak, Julie “Choice Matters: What needs to change to make schools competitive?”, Policy, Autumn 2006, The Centre for Independent Studies.

In his important book, “Education Matters”,⁴⁴ Dr Mark Harrison spells out in some detail the reasons for this and deals effectively with criticisms of the competitive approach. He points out, in particular, that an education system that is established and operates under competitive conditions is more likely than a monopoly state system to have greater involvement of parents and a strengthened role of families. He does not argue, however, that parents or even local communities should help run schools. Rather that, if parents are able to choose schools that reflect their values, this is more likely to create a sense of community than if schools are run from Mary St in Brisbane. Recognition of this by the Queensland government through policy changes along the lines outlined above would be a smart initiative.

Hospitals

The dramatic increase since 1997-98 from 36 to 47 per cent in the proportion of patients treated at private hospitals (Table 49) – the highest amongst the states – provides a clear indication of the trend in preferences of the Queensland community. These preferences will have been enhanced by the recent problems that have emerged in the public hospital system and by the growing recognition that private hospitals in Queensland now have the capacity to perform almost the full range of complex treatments (Table 50): indeed, private hospitals Australia-wide now perform the majority of surgery and, of the 660 different procedures and treatments undertaken, they provide 653.⁴⁵ Importantly, such treatments are of a high quality: in 2005 the Australian Council on Healthcare Standards (an independent body that assesses quality accreditation for the majority of public and private hospitals) reported that private hospitals generally performed better than public hospitals in all mandatory criteria. In fact private hospital groups in Queensland advise that they have compliance and risk assessment units that apply comprehensive performance monitoring measures and standards. Moreover, there is evidence suggesting that Queensland private hospitals are performing more efficiently than their public counterparts: cost weight data compiled by the Australian Institute for Health and Welfare show significantly lower average costs in private hospitals in 2003-04 (see Table 54). With about half of the treatment market in Queensland, private hospitals have thus clearly established themselves as totally credible alternative providers.

By contrast with the schools sector (where a much slower growth in Queensland’s school age population will reduce needed growth in school education spending), the ageing of the population and the general demand for additional health treatments are likely to at least sustain the growth in overall hospital separations.⁴⁶ Although improved hospital productivity (reflected in, inter alia, the increased proportion of overnight and same day treatments as shown in Table 51), will likely reduce the demand for hospital beds, total separations from 2003-04 to 2009-10 may increase as fast as the 27 per cent increase in the previous six years.

In such circumstances, if the increased trend to private hospital treatment in the six years to 2003-04 were also to continue out to 2009-10, separations by such hospitals would reach around 60 per cent of total separations and the net *annual* saving in recurrent expenditure for the public hospital system would increase from nearly \$1.9 billion (in 2003-04) to \$3.8 billion in 2009-10 (Table 62). In addition, there would be a further reduction in the number of public hospitals (given the decrease of 12 over the six years to 2003-04, a further 30 could cease by 2009-10) which could yield \$150-200 million in proceeds available for other capital spending (Table 63).

⁴⁴ “Education Matters Government, Markets and New Zealand Schools”, February 2004, the Education Forum, Wellington.

⁴⁵ Private hospitals are not permitted to perform transplants.

⁴⁶ In 2003-04 patients aged 65 and over represented 35 per cent of admissions to private hospitals and 34 per cent to public hospitals. Patients aged 75 and over represented 20 per cent of admissions to private hospitals and 19 per cent to public hospitals.

How the Private Sector's Role Can be Increased

Changes in state policies that would help increase treatments in private hospitals would include:

- Although the state government has no existing “scheme” for providing financial assistance to private hospital groups, adoption of a policy of making low interest loans available to such groups on a similar basis to that outlined above for non-government schools would help provide an assured basis for private hospital groups to fund the further large expansion in demand for their services that appears in prospect. As indicated in the Statistical Appendix, if separations by private hospitals increased at the same rate as in the six years to 2003-04, by 2009-10 that would require a further large increase in either the number of private hospitals or in their average size.

In the six years to 2003-04 the large increase in separations was mainly accommodated by the 47 per cent increase (from 71 to 104) in the number of private hospitals (Table 48), with the average size increasing by only 12 per cent, from almost 5,500 to over 6,150 separations per annum, compared with average separations of about 4,000 per annum in public hospitals (Table 63). However, as advice from private hospital groups suggests that the accessing of suitable capital for new hospitals has become more difficult, the projected increase in demand for treatment may now have mainly to be absorbed through increases in average hospital size. Even so, there would still need to be a major increase in the number of private hospitals;

- The government should also help the further expansion/establishment of private hospitals by making it harder for those who are insured to access public hospitals as private patients. According to the Australian Private Hospitals Association, 6.5 percent of patients in Queensland public hospitals were private in 2003-04. The change in Queensland policy to allowing public hospitals to retain moneys received from private patients, instead of requiring them to pass such receipts direct to the Treasury, has encouraged administrators of individual public hospitals to compete more aggressively for private patients. While the spirit of competition should not be discouraged, it does not appear appropriate in circumstances where public hospitals have considerable waiting lists of patients who are not insured.

The government should discuss this situation with the federal government with a view to securing its agreement to a policy of putting insured patients on a “special” waiting list that would normally involve a 12 month wait for treatment and to amending the Health Care Agreements in 2008 to exclude insured patients from treatment in public hospitals except in circumstances where it would not be practicable to obtain private hospital treatment. The government should also reverse the policy of allowing public hospitals to retain money received for treatment of private patients;

- As a component of the above, the government should make it clear that, as a matter of general policy, it supports a further expansion in the private hospital sector. The Queensland Health Strategic Plan 2004-2010 published in 2004 acknowledged (page 8) that Queensland Health itself is “only one provider of health services” and that “it will also work more closely with health sector partners, including general practitioners, private specialists and private hospitals and with non-government agencies providing community-based services.” However, while this approach has led to the appointment of private sector representatives to three ministerial committees and is generally welcome, it fails to identify the expected extent of, and policy towards, the respective roles of the public and private sectors. Moreover, the announcement in February 2006 of very large increases in wages for public hospital doctors and nurses appears to have been made without regard to the financial difficulties created for private hospitals locked into contracts with health funds. In addition, in the context of a by-election in April on the Gold Coast, the Premier indicated that there would be a three month

public consultation period regarding the previously mooted idea of constructing a new *public* hospital alongside Griffith University by 2015.

This approach by the government is a continued reflection of its tendency to pursue policies that focus on the role of the government in isolation and take inadequate account of what might be in the best interests of the community as a whole. At a minimum the government should indicate that, consistent with the reduction of 12 public hospitals in the six years to 2003-04 and the expected further growth in private hospital treatment, it envisages a further major expansion in the private hospital sector and a reduction in the number of public hospitals.

Future state policy in regard to private hospitals, and in regard to the general role of private sector groups in competing for the delivery of public hospital services, has the potential to exercise a major influence on the attitude of the Queensland community towards the health system and government itself. While the revealed problems within the public hospital system may be alleviated to some extent by the provision of additional funding, they are unlikely to be overcome in an insufficiently competitive environment. Such an environment cannot be created overnight but the establishment of a policy sympathetic to the role of private health groups would be a major step forward and would also help improve the budgetary outlook.

Investment in Capital for Public Sector Services (incl by Public Corporations)

In an economy that is growing relatively strongly (as Queensland's has been) investment naturally makes a major contribution and, in areas where the public sector has assumed responsibility for the provision of services, it should be either increasing its infrastructure investment at a rate that does not hold back private sector investment or passing the responsibility to the private sector itself. Between 1997-98 and 2004-05 total investment by the Queensland public sector (Table 9) averaged just over 5 per cent of GSP, with investment by public corporations averaging around 2 per cent. While (unsurprisingly) this constituted for both total investment and investment by public corporations the highest rate of such investment amongst the states, there appeared to be a downward trend in the contribution of such investment to GSP. Further, the latest budget estimates (including projections to 2008-09) suggest that, apart from an estimated substantial increase back to 5 per cent of GSP in 2005-06, investment by both the general government and public corporations sectors will again trend downwards both in nominal terms and as a proportion of GSP (Table 64).⁴⁷

How these projections are to be interpreted against the background of the announcement by the government of a 20 year plan for additional infrastructure investment of \$55 billion⁴⁸ - an average of \$2.75 billion a year in nominal terms - is impossible to assess. Annual investment at that average rate implies a much smaller investment than the current public sector rate of \$7.8 billion and it is also difficult to see to what the basis is for categorising it as "additional".

Against this background, the government needs to address two basic questions in regard to the respective public and private responsibilities for investment in what has been the traditional public sector.

First, what role in *general government* sector investment is it envisaged that the private sector should play?

⁴⁷ Queensland budget projections show a decline in total public sector investment (gross) from \$8.1 billion in 2005-06 to \$6.4 billion in 2008-09.

⁴⁸ The Budget's Capital Statement for 2005-06 does not identify specific investment projects for this \$55 billion South East Queensland Infrastructure Plan and Program from 2005 to 2026. The statement simply indicates that \$24.5 billion is to be expended on road and public transport projects (plus a possible further \$11 billion), \$3.4 billion on social and community infrastructure, and \$3.4 billion also on energy networks in the next five years (with a possible further \$10.3 billion after that).

How the Private Sector's Role Can be Increased

As already indicated, so far the Government has been cautious to the point of leaving the position uncertain. The budget capital statement for 2005-06 provides no more than a vague indication that private sector participation “can assist the timely delivery of efficient and effective infrastructure ... (but) there is a need for careful analysis and management before any commitment is made” to such participation. But, given the increasing resort amongst the states to contracting out and PPPs, there should at least be a statement of policy to the effect that they will be used wherever it is practicable and efficient to do so.

Such a statement would also seem justified by the government's own actual or foreshadowed involvement in some individual projects involving the private sector. These include the Southbank TAFE re-development, the North South Bypass and Airport Link roads/tunnels, and cruise ship terminals.⁴⁹ Further, the government recently announced that over the next twelve months it will evaluate \$5.6 billion worth of potential public-private projects as part of the \$55 billion infrastructure program.⁵⁰ In these circumstances it is difficult to see what is holding back a general policy statement.

The second basic question is what is the government's policy towards the future role of public sector corporations which operate trading enterprises covering a wide range of activities, including energy, transport, water, forestry, ports, funds management, gaming and natural resources? These account for about 60 per cent of total investment by the public sector and clearly cover areas where private sector enterprises could operate on a competitive basis provided it is feasible to establish clear contractual and operating systems.

Although a 24 April report commissioned by the Government from Boston Consulting apparently recommended the sale of all electricity assets, the Premier rejected any sale of generation and transmission assets. His reported statements that “we are keeping the family silver” and that state ownership would maintain low electricity prices overlook the poor returns from family silver and that there are other ways of maintaining low electricity prices. A policy more *generally supportive* of privatisation would be justified by both the recent performance of existing corporations and the likely benefits from a more competitive framework to supply relevant services. As the budget strategy and outlook paper for 2005-06 rightly points out, increasing the efficiency of the existing capital infrastructure stock by reducing input costs or increasing usage under competitive conditions can make an important contribution to improving productivity.⁵¹

However, as revealed in the July 2005 Productivity Commission report on the performance of 83 government trading enterprises in all states,⁵² in 2003-04 earnings on assets of 16 owned by the Queensland Government ranged between 8.3 and -3.3 per cent, with a (simple) average of around 5 per cent (see also Public Investment and Public Corporations in the Statistical Appendix). This compares with the standard average cost of capital for Australian companies with 40 per cent gearing of about 9.5 per cent ie the capital employed by Queensland publicsector corporations is yielding a return well below that on capital employed in the private sector, implying an inefficient use of scarce resources.

⁴⁹ It is not clear from the references in the budget's capital statement for 2005-06 whether it is envisaged that these and other projects listed would involve joint funding of some kind or whether they are simply possible private sector projects on government owned or controlled land and/or requiring government approval.

⁵⁰ “Queensland set to assess \$5.6 bn in PPPs”, Australian Financial Review, 3 March 2006. In addition to road projects, reference is made to a school and a hospital project. The report also indicated that two private sector firms will run a program management office for the \$55 billion infrastructure program, reporting to the co-ordinator general.

⁵¹ Concern is sometimes expressed that privatisation results in undue emphasis being placed on operating at a profit. However, having the profit motive is the driving force to operating efficiently and does not, in itself, lead to inequitable income or wealth distribution. Nor need privatisation prevent the continued provision of community service obligations.

⁵² Financial Performance of Government Trading Enterprises 1999-00 to 2003-04, Productivity Commission Research Paper, July 2005.

Moreover, this return on public sector corporation assets is calculated by including as “revenue” the more than \$900 million provided by the Queensland Government for community service obligations (CSOs).⁵³

The Productivity Commission has also pointed out that:

- The profitability of the 50 government trading enterprises monitored continuously since 1999-00 did not improve over the period;
- Nearly half the 83 enterprises currently monitored earned less than the long term bond rate in 2003-04 and a greater number failed to earn a commercial rate of return;
- Governance arrangements should be improved by clarification and public scrutiny of the rationale for ongoing ownership of the enterprises;
- There should be improved transparency of the external governance role of ministers.

The 20 public corporations owned by the Queensland Government have an estimated total value of over \$22 billion and, if sold at that value, could provide savings in interest to the public sector of \$1.2-\$1.4 billion per annum. As they also contribute to the budget around \$600-\$700 million a year in dividends and about \$400 million a year in tax equivalent payments, their sale could thus produce a net saving to the Queensland budget in the range of \$100-400 million pa. Through improved efficiency of private enterprises it should be also possible to effect savings in the amount of community service obligations required to be provided by the government.

Of course, an improvement in the performance of the existing assets of public sector corporations may be achieved other than by outright sale. It may be more appropriate, for example, to have a contracting out arrangement where there is an inherent monopoly situation, as with the transmission of electricity. The franchising of the operation of some services, as with metropolitan transport in Melbourne, may also achieve the principal objective, viz. to establish a competitive framework, while retaining state ownership of the assets. However, there appears to be a strong case for selling most of the state’s assets in the electricity, ports, and forestry sectors ie most of the \$22 billion of assets. Whatever course might be taken, there would be a need for an independent regulator of competition and the continued provision of appropriate subsidies for low-income and disabled users through the payment of community service obligations.

⁵³ An improvement in returns on capital may be achieved by improvements in efficiency or increases in the prices charged for services – or some combination of the two. Historically, some privatisations (such as those involving water supplies in the UK) have involved increases in prices where the public sector bodies have been undercharging for political or traditional reasons. While this would involve a desirable improvement in the use of resources, in order to obtain political acceptability it may require during a transition period the provision of subsidies to the privatised enterprise and/or the imposition of regulatory limits to price increases.

A Package of Lower Taxation & Regulation

A Package of Lower Taxation & Regulation

If the government were to change its general policy stance to one openly sympathetic and conducive to establishing a relatively larger role for the private sector, that would obviously be helped if it was also able to indicate that it is aiming to effect a major reduction in the level of state taxation. There are two ways in which this might be approached.

First, by examining areas where there would be scope to reduce expenditure if, as a matter of overall policy, there is potentially greater priority to lowering taxes rather than continuing with a subsidy or the current rate of spending on some particular item or items.

Items of spending identified by the Commonwealth Grants Commission as above the average for the states would be potentials for reduction. As already indicated, these include Electricity and Gas tariffs policy (in 2004-05 about \$155 million or 160 per cent above), Non-Urban Transport (\$82 million or 44 per cent), Roads (\$53 million or 5 per cent), Petroleum subsidies (\$391 million or 320 per cent) and General Public services (\$407 million or 40 per cent), giving a total in 2004-05 of \$1,088 million above the average.⁵⁴

Of course, there would be opposition from those who would be adversely affected by reductions in these areas. But, if the reductions were presented as part of a package designed to reduce taxation and promote the role of the private sector, it would have greater acceptability and, presumably, support particularly from the business community. For example, the elimination of petrol subsidies could finance a substantial reduction in motor vehicle taxes, which are estimated to yield \$1,052 million in 2005-06. Similarly, a reduction to the states' average in expenditure on the amorphous "general public services" could be presented as helping finance a major reduction in payroll taxes, which are estimated to yield \$1,767 million in 2005-06.

In establishing an independent, statutory Service Delivery Commission in October 2005 the Premier indicated that the minimisation of duplication and inefficiencies was expected to provide savings rising to \$100 million per annum by 2010-11. These might include savings from switching to the use of private sector services by selling the Government Printer and eliminating the centralised purchasing functions and centralised maintenance workforce in the public works department. There is also a case for examining whether funds presently used to provide incentives to invest in Queensland might be better used as part of a taxation reduction package.

In circumstances where the state faces the prospect of a much slower rate of growth in revenue than in recent years (see "Queensland's Budgetary Outlook" above), a case can also be made to effect at least a temporary reduction in the growth of both public service employees and their remuneration. As already noted, total public sector employees have been increasing faster than the average for the states and in 2004-05 were about 8,000 or 3.3 per cent above that average. A recent report by the Office of Public Service Merit and Equity⁵⁵ (which covers public service employees only) shows that, although there were fewer lesser skilled workers in 2005 than in 2000, a surprisingly large number (around 8,000)

⁵⁴ The above average expenditure on electricity and gas relates to changes in electricity policy in the late 1990s when the government made a commitment that state-wide uniform retail tariffs would apply to franchise customers and that no such customer would be adversely affected by ongoing electricity market reforms. However, with the move to full retail contestability, this policy seems outdated. The petroleum subsidies were provided as an offset to the price increases following the introduction of the GST and also seem outdated today. The expenditure category "general public services" embraces a vast list of expenditures that include regulatory and administrative activity by the state.

⁵⁵ "Growth in the Queensland Public Service Workforce 2000-2005", February 2006.

continued to be employed as public servants (these included cleaners, cooks, gardeners, and waiters) rather than under outside contract arrangements. Average earnings (gross) per public sector employee have also been growing at a slightly faster rate than the states' average and in 2004-05 were above the level in every state except NSW (where they were an extraordinary 10 per cent above the states' average).

A "package" that included a policy of tax reductions over, say, five years could be partly financed by limiting over the same period the growth in numbers of such public service employees to, say, 1 per cent per annum and limiting the growth in average earnings of the 193,656 Queensland public service employees in 2004-05 to the same rate as inflation. That could save around \$250-300 million per annum. The rationale for such a policy would include the reduced capacity for expenditure growth, the apparent scope to reduce the number of departments through amalgamations of those with similar or overlapping functions (such as State Development and Innovation with Treasury, Communities with Local Government, Planning, Sport and Recreation, Legal Aid and Industrial Relations with Justice and Attorney General, Housing with Public Works), and the potential for increasing the private sector's role in providing traditional "government" services.

However, while a five year period of slower growth in public service numbers and earnings would help improve the budgetary situation, given Queensland's relatively rapid growth in population, such a policy would not be sustainable unless accompanied by a major increase in the role of the private sector in the delivery of services.

Over the same five years action could also be taken to sell the major assets of public corporations and/or contract out/franchise some of the services. As indicated above, this should produce substantial once-off net capital proceeds that should allow a reduction of, say, \$100 million per annum in payments of both interest (net of dividends and tax equivalent payments) and community service obligations.

The second main way in which expenditure might be reduced would be through the proposed changes in state policies to adopt the purchaser/provider approach and to encourage the development of competing private sector services. Over, say, five years each of these approaches could be expected to save and/or reduce the need for expenditure by the government, although it is difficult to estimate the possible extent of annual savings.

One example of potential savings *in addition to what might otherwise occur* is given in the Education section of the Statistical Appendix (Tables 45-46), where a comparison is made of the possible annual savings from an increase in the proportion of school students attending non-government schools by 2010-11 to 32.7 per cent (which is what might be expected if recent trends continued) and 36 per cent (which is what might be expected if schools policies were to be "liberalised"). Although the estimated *addition* to annual savings from reaching 36 per cent is only about \$30 million, if the schools policy were to be changed as suggested, other savings seem likely, including the one-off proceeds from the sale of school sites no longer needed.

In the hospitals sector, on the basis that recent trends in private hospital separations continue the projected additional annual saving could average around \$330 million over the period to 2010-11 (Table 62). However, the achievement of that would be partly dependent on a liberalisation of state policies along the lines proposed. As with the proposed schools policy, there would also be significant one-off proceeds from the sale of unwanted public hospital sites.

A Package of Lower Taxation & Regulation

In summary, adoption of the approach outlined has the capacity, over time, to allow a reduction in state taxes of the order of \$1,000-1,500 million per annum. That would be a significant change compared with estimated state tax revenue of nearly \$7 billion in 2005-06 and, particularly if announced as a component in the objective of increasing the private sector's role, could be expected to heighten the private sector's interest in investing in Queensland.

That interest would also be heightened by a reduction in the regulation of businesses. A new approach is needed based on assessing whether, in the competitive framework in which business now operates, there is a serious risk of damage or harm if such a reduction were effected. Much of state regulation of workplace relations, for example, is based on the outdated concept that there is an imbalance of bargaining power between employers and employees.

Partly because the deterrent effect of regulation on private investment and economic activity arising from the compliance costs has been well analysed elsewhere, this report does not attempt any detailed assessment. Mention should be made, however, of the OECD's recent estimate that the compliance cost of regulation for small and medium sized Australian businesses is now more than \$17 billion and the recent study by the Business Council of Australia estimating the cost as equivalent in 2003-04 to around eight per cent of GDP (or about \$63 billion). It is hoped that the Australian Government's Regulation Taskforce, headed by Productivity Commission Chair, Gary Banks, will lead to a reduction in the compliance burden on business from regulation (including Commonwealth-State regulatory overlap).

That is certainly needed in Queensland. Legislation passed in that state has ballooned from 13,873 pages during the 1960's to 77,516 pages so far this decade. That is the highest growth rate amongst state governments, implying that the "low tax State" of Queensland risks becoming the 'high regulation State', with individual businesses devoting increasing time and incurring considerable financial costs in meeting regulatory requirements. Extensive regulations can have a similar deterrent effect on investment as taxation.

The problems associated with the regulation of business operators are apparent across a wide number of policy areas, including workplace health and safety (where Queensland employers may be held accountable for individual actions based on events outside the workplace and outside employers' control); building and construction (where a vast array of standards/codes are laid down and where employers have to cope with a workplace relations system that seems excessively under the influence of trade unions); and environmental standards (where, for example, the ban under the Vegetation Management Act on the clearing of "endangered" remnant native vegetation inhibits the expansion of agricultural activities by making rural properties effective "heritage" sites and where Productivity Commission analysis suggested that limits on tree clearing could reduce the present value of expected net returns by between \$42 million and \$124 million in Murweh Shire alone).

The government seems to have acknowledged that the extent of state regulation constitutes a major problem for Queensland businesses. However, while it has established a process of 'Review of Hot Spots for Regulatory Reform' in the Department of State Development, Trade and Innovation, this has not so far produced a coherent framework for a major reduction in existing regulations (including meaningful targets and reform timetables). The establishment of such a framework would be better handled by the state Treasury in cooperation with the business community and should be another component in the adoption of a policy to encourage the private sector's role in the state.

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